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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

FREEPORT-MCMORAN INC., *et al.*,
Petitioners,

v.

K N ENERGY, INC.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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BRIEF OF THE FERTILIZER INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

When private parties contract for the sale of goods in interstate commerce, may a federal court sitting in diversity disregard the applicable state law governing construction of contracts in favor of its own notion of federal common law rules of contract construction?

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BRIEF OF THE FERTILIZER INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

The Fertilizer Institute, on behalf of its member companies, submits this brief as *amicus curiae* in support of the petition by Freeport-McMoRan Inc. for a writ of certiorari to review the decision of the United States Court of Appeals for the Tenth Circuit reported at 942 F.2d 765.[1]

INTEREST OF AMICUS CURIAE

The Fertilizer Institute (TFI), a trade association of approximately 300 companies, represents the fertilizer industry in the United States. TFI's members and their affiliates have entered into countless contracts for the purchase and shipment of products in interstate com-

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[1] The petitioners and respondent have consented to the filing of this brief. The letters granting their consent have been filed with the Clerk of the Court.

merce. The Tenth Circuit's federal rule of contract construction, if allowed to stand, would apply to provisions which appear in many of those contracts. As the "Tenth Circuit definition" will often be contrary to the intent of the contracting parties, the parties' legitimate business expectations will be thwarted. Moreover, as the Tenth Circuit's ruling is irreconcilable with a Fifth Circuit holding, the law governing contracts covering interstate commerce will be confused and unsettled until this Court resolves that conflict. Faced with the potential disruptive effect on the interpretation of numerous contracts, TFI and its members have a vital interest in this Court's review of the decision below.

STATEMENT

The Tenth Circuit seems determined to overturn Freeport-McMoRan's trial verdict against respondent K N Energy, regardless of the precedent it sets. The district court entered that verdict in this contract dispute after considering extensive evidence regarding the parties' intent. On an appeal by K N Energy, the Tenth Circuit first overturned the verdict on jurisdictional grounds. Those grounds had never been briefed or argued by the parties, and the Tenth Circuit's decision conflicted with prior decisions by this Court and other circuits. Accordingly, this Court granted certiorari and summarily reversed. *Freeport-McMoRan Inc.* v. *K N Energy, Inc.*, 111 S. Ct. 858 (1991).

On remand, the Tenth Circuit once again overturned Freeport-McMoRan's verdict. This time, the Tenth Circuit fashioned a new federal rule of contract interpretation, contrary to both the applicable state law and the evidence of the parties' actual intent. Pet. App. at A-1, A-7. As before, the Tenth Circuit has miscalculated the power of a federal court sitting in diversity. In doing so, that court has created a troubling precedent conflicting with the holdings of this Court and at least one other Circuit. This Court therefore should grant certiorari to

review the Tenth Circuit's new decision or, as it did before, correct the error through summary reversal.

The pertinent factual background is straightforward and readily demonstrates the ramifications of the Tenth Circuit's decision. Freeport-McMoRan and respondent K N Energy are parties to a long-term contract for the purchase and sale of natural gas. Following changes in the natural gas market, a dispute developed regarding the meaning of the phrase "sold under similar terms and conditions." Invoking federal diversity jurisdiction, Freeport-McMoRan brought suit against K N in federal district court alleging breach of contract. After a full trial on the merits, the district court upheld Freeport-McMoRan's interpretation of that phrase, based on state law and extrinsic evidence of the parties' actual intent. Pet. App. A-18 through A-31.

The Tenth Circuit, in its second reversal, chose to ignore state law and, borrowing from the *Restatement of Contracts*, concocted a new legal definition for the disputed contract language. First, the court determined that in the contract phrase "terms and conditions," "the use of the word 'terms' is separate and distinct from that of 'conditions.'" Pet. App. at A-7. The court then defined the word "terms" as a matter of federal law to mean " 'that portion of the legal relations resulting from the promise or set of promises which relates to a particular matter, *whether or not* the parties manifest an intention to create those relations.' " Pet. App. at A-7 (*quoting Restatement (Second) of Contracts* § 5 (1981)) (emphasis added).

As a result, federal district courts within the Tenth Circuit must construe contracts containing the word "terms" consistently with the Tenth Circuit's definition and without regard to the contracting parties' actual intent. State courts within the Tenth Circuit, however, and other Circuits will continue to apply state law rules in the construction of contracts, following the same approach as the district court in this case. Thus, what the

Tenth Circuit has done is undeniable. It has tacitly fashioned a federal common law rule governing the construction of contracts.

REASONS FOR GRANTING THE WRIT

Certiorari is warranted for several reasons. First, the Tenth Circuit's decision is irreconcilable with *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64 (1938). The decision also conflicts with the Fifth Circuit's decision in *Pennzoil Co.* v. *FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982).

Second, the decision below will disrupt the settled expectations of numerous other businesses. In light of *Erie*, contracting parties fully expect state law to govern the interpretation of their contracts. The Tenth Circuit's decision upsets that expectation, thereby potentially altering the interpretation of literally hundreds, if not thousands, of contracts which the parties contemplated would be interpreted by applying state rules of construction in the event of dispute.

Third, the Tenth Circuit's decision will create widespread uncertainty, due to the prevalent use of the phrase "terms and conditions" in American contracts. This uncertainty will also provoke unnecessary litigation as parties benefitting from the new federal interpretation contest the previously settled meaning of their contracts. In the ensuing litigation, the parties filing first in state courts and the Fifth Circuit will have their disputes decided under state law. Yet in the six states covered by the Tenth Circuit, "federal" law will apply to a suit brought in or removed to federal court.

A. The Tenth Circuit's Decision Directly Conflicts With This Court's *Erie* Standard And A Fifth Circuit Decision.

In *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), this Court held that "[e]xcept in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State." 304 U.S.

at 78. Since *Erie*, this Court has emphasized and reemphasized "that where 'litigation is purely between private parties and does not touch the rights and duties of the United States,' " state law supplies the rule of decision. *Boyle* v. *United Technologies Corp.*, 487 U.S. 500, 506 (1988) (*quoting Bank of America Nat'l Trust & Savings Ass'n* v. *Parnell*, 352 U.S. 29, 33 (1956)).

The Tenth Circuit ignored *Erie* and construed the contract in disregard of state rules of contract construction. Colorado and Montana—the two states whose law might govern (*see* Pet. at 7-8)—require that contracts be interpreted consistent with the parties' intent.[2] In contrast, the Tenth Circuit concluded as a matter of federal law that there is a distinction between the meaning of the word "term" and the meaning of the word "condition," and then went on to define the word "term" also as a matter of law. Nowhere did the court consider whether the parties intended "term" to be given a technical legal definition or if the parties intended "terms" to be distinguished from "conditions".[3] Consequently, the Tenth Circuit's decision cannot be reconciled with the relevant state law. Indeed, the Tenth Circuit has tacitly, but undeniably, crafted its own federal common law rule. *Erie* forbids that result.

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[2] *See, e.g., Martinez v. Continental Enterprises*, 730 P.2d 308, 319 (Colo. 1986); *Foster v. Realty Title Co., Inc.*, 680 P.2d 323, 327 (Mont. 1984).

[3] Although the Tenth Circuit did suggest that its interpretation was consistent with the parties' intent, the court emphasized that "we must look first to the meaning of the words" as a matter of federal law and only then considered the parties' intentions in that light. Pet. App. A-7. The district court specifically found, after listening to the testimony at trial, that the parties actually intended just the opposite of what the court of appeals concluded. Pet. App. at A-25. The Tenth Circuit never even mentioned that finding or cited the relevant testimony, much less gave any reason for overturning the district court's findings of fact. *Compare* Pet. App. at A-9 (citing only testimony relating to current prices).

The Tenth Circuit's decision also conflicts directly with the Fifth Circuit's holding in *Pennzoil Co.* v. *FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982). In *Pennzoil*, the court ruled that *Erie* requires that the FERC apply state law when interpreting contracts for the purchase of natural gas. 645 F.2d at 383-84. Notably, *Pennzoil* contrasted its holding with that of an earlier Tenth Circuit case which foreshadowed the erroneous reasoning now before this Court. Specifically, in *Public Serv. Co. of New Mexico* v. *FPC*, 557 F.2d 227 (10th Cir. 1977), the Tenth Circuit determined that "federal" law should be applied in interpreting a contract for the sale of federally regulated electricity, thus making it "unnecessary for us to examine New Mexico law . . . ." 557 F.2d at 231. Although the *Pennzoil* court attempted to distinguish *Public Service*, *see* 645 F.2d at 387 n.56, the Tenth Circuit's decision here extends even further the *Public Service* approach and demonstrates that the Circuit conflict is irreconcilable.

This conflict among the circuits by itself signals a need for review by this Court, even if that review is to summarily reverse the Tenth Circuit's decision. *Wallis* v. *Pan American Petroleum Corp.*, 384 U.S. 63, 66-67 (1966) (granting certiorari to resolve conflict in Circuits regarding the application of federal or state law to lease of federal lands). The disruptive consequences of the Tenth Circuit's decision make the need for review even more compelling.

B. The Tenth Circuit's Decision Will Revive Forum Shopping And Other Evils *Erie* Sought To Prevent.

In *Pennzoil*, the Fifth Circuit observed that allowing federal courts to create and apply federal common law in contract interpretation would result in the "very evil that *Erie* addressed . . . ." 645 F.2d at 384. Prior to *Erie*, under *Swift* v. *Tyson*, 41 U.S. 1 (1842), litigants who were able to establish diversity jurisdiction could have their disputes determined by a federal court apply-

ing federal common law principles. Similar litigants who were unable to establish federal court jurisdiction had their disputes litigated in state courts applying state law. This led to potential litigants playing musical states of residence to gain the advantage of either the state rule or the federal common law rule. *See Erie*, 304 U.S. 73-75. After commenting on *Swift*'s invitation to forum-shopping, the Court lamented that "the [*Swift*] doctrine rendered impossible equal protection of the law." *Erie*, 304 U.S. at 75.

Now, over fifty years after *Erie*, the Tenth Circuit has breathed new life into the *Swift* doctrine. The law of each state located within the Tenth Circuit requires courts to interpret contracts consistent with the intent of the parties.[4] To an unknown extent, but at least with respect to the ubiquitous word "terms," federal district courts in the Tenth Circuit will have to define certain words applying a technical legal definition, rather than the definition intended by the contracting parties. For the very reasons laid out in *Erie*, this Court should not tolerate such atavism. The *Swift* doctrine is dead for good reason, and this Court should not permit it to be revived in a disguised form.

The Tenth Circuit's decision invites forum shopping. If the state law favors the potential plaintiff, that party will file in the state court. If the state law is unfavorable, the federal court might prove a more advantageous forum. That was the problem with *Swift*; it was the reason for *Erie*.

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[4] *See, e.g., Winegar* v. *Froerer Corp.*, 813 P.2d 104, 108 (Utah 1991); *True Oil Co.* v. *Sinclair Oil Corp.*, 771 P.2d 781, 790 (Wyo. 1989); *City of Arkansas City* v. *Anderson*, 752 P.2d 673, 679 (Kan. 1988); *Martinez* v. *Continental Enterprises*, 730 P.2d 308, 319 (Colo. 1986); *Mercury Inv. Co.* v. *F.W. Woolworth Co.*, 706 P.2d 523, 529 (Okla. 1985); *Manuel Lujan Ins., Inc.* v. *Jordan*, 673 P.2d 1306, 1308 (N.M. 1983).

C. The Tenth Circuit Rule Will Create Havoc In Interpreting Numerous Outstanding Contracts.

The Tenth Circuit did not "interpret" some arcane word or phrase: It interpreted a word in a common contract phrase—the word "terms," in the phrase "similar terms and conditions." That phrase appears in literally hundreds of contracts to which TFI members are parties and in innumerable contracts of other types.[5]

The potential mischief of the Tenth Circuit's decision is far reaching. That Circuit has tacitly declared that it will displace state law and ignore the intent of the contracting parties, in favor of its own rules of construction and its own *ex cathedra* determination of what contract words mean. This Court has previously eschewed the adoption of such rigid, legalistic definitions when interpreting the words of a contract, and especially definitions that may be divorced from the parties' specific intent.[6]

Not only has the Tenth Circuit adopted an imprudent rule as the federal rule, but its decision will also create widespread uncertainty where the contracting parties previously believed that certainty existed. Contracting parties typically expect that their words will be construed consistent with their intent and the laws of a particular

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[5] *See, e.g., Modern Sys. Technology Corp.* v. *United States*, 24 Cl. Ct. 360, 362 (1991); *Dale Mortgage Bankers Corp.* v. *877 Stewart Ave. Assocs.*, 518 N.Y.S.2d 411, 412 (1987). *See also* 18 Am. Jur. 2d *Legal Forms* § 253:252 (provision using the phrase "terms and conditions"), § 253:1563 (provision using the phrase "terms and provisions").

[6] *See Skelly Oil Co.* v. *Phillips Petroleum Co.*, 339 U.S. 667, 678 (1950) (language in a natural gas contract was the same as that in a federal statute with a settled interpretation, but "this language in the contract may have a scope independent of the proper construction of [the language in the statute]. The same words, in different settings, may not mean the same thing."); *see also Columbia Gas Transmission Corp.* v. *Allied Chemical Corp.*, 652 F.2d 503, 508-09 (5th Cir. 1981) (holding that the term "inadvertence" in a gas contract should not be defined by application of the "technical definition" given the word when it appears in a federal rule of procedure).

state. For that reason, this Court has expressed repeated reluctance to displace state law where persons have formed such expectations. *See, e.g., Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 479 (1977); *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 729 (1979). The Tenth Circuit's decision is unfaithful to the spirit of those cases.

CONCLUSION

For these reasons, and the reasons set out in Freeport-McMoRan's petition, this Court should grant certiorari and either review the decision below on the merits or summarily reverse the Tenth Circuit panel again.

Respectfully submitted,

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